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## THE FINANCIAL SITUATION: A GENERAL SURVEY

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Let me begin with a sketch in broad outline of the general situation, a survey of the expenditures which we shall have to face, of our available resources, the prospects for the immediate future and for the more distant future. Nothing more than an approximation to accuracy is now possible; but we can reach an approximation sufficient for an understanding of the tasks and burdens which confront us.

In round numbers, the total appropriations which Congress has made for the fiscal year 1917-1918 come to nineteen billions of dollars. In some of the formal statements the total seems to be much less—no more than twelve billions. But this smaller sum includes only those expenditures which are directly and strictly our own and does not include loans to the allies which are expected to amount to some seven billions of dollars. It has been officially stated that up to October 1 these loans amounted to something over two billions of dollars; we are told to expect five billions more, or a total of seven billions.

### THE AMOUNT OF FUNDS PROVIDED

Against this imposing sum of nineteen billions we have now provided, or undertaken to provide, perhaps eleven billions. The liberty bonds of the first issue produced two billions. Those of the second issue are expected to provide not less than three, nor more than five billions, and have in fact yielded \$4,617,532,300. The total tax revenue, under the provisions of law in effect before the beginning of this year's special session of Congress, amounted to one and one-third billions. The additional revenue under the war revenue act which became law on the third of October is expected to be two and a half billions. In all, therefore, we have provided for something over four billions by taxation and five to seven billions by loans. These are stupendous sums; but nowadays we have to put our figures in terms of billions, no longer in

terms of millions. The warfare of our time is on a stupendous scale and calls for stupendous expenditures.

Some of the items mentioned in this summary call for comment. Our loans to the allies are not always figured as expenses or charges. As I have just stated, they do not figure in our official statements of appropriations. And in a sense they are not expenditures of our own and call for no appropriations of our own. They are loans for which we get a *quid pro quo* in the form of promises to pay from the allied governments; and ultimately these obligations will be repaid. But for the time being the transactions mean a charge of our own, to be met from our own resources. During the continuance of the war and for such period after its close as we may still be extending aid to our allies, we must raise these sums by taxation or by loans and must face them as an immediate drain upon our present resources.

Another item which calls for comment is the revenue to be derived from the War Tax Act, expected to amount to two and one-half billions. Will it be just so much, or will it be more or less? On this topic we must speak with reserve. The amount which will be procured from some of the new tax levies is open to speculation; particularly as regards the one item which bulks largest in the act, namely, the excess profits tax. It remains to be seen what will be the final accruing revenue under this tax and under the others newly levied. But even a considerable margin of error due to such uncertainties will not seriously affect the general situation. The tax revenue under the act may amount to a few hundred millions more or a few hundred millions less than was anticipated. But as we know too well, a few hundred millions figure very little in these days; we frequently pay out sums of this amount over night in loans to our allies.

Whatever sort of calculation we make, one thing is clear, namely, that the revenue resources so far provided will not suffice for the presumable expenditures of the fiscal year 1917-1918. We have provided ten or eleven billions; we have appropriated nineteen billions. The expenditures may be somewhat greater than the appropriations, may be somewhat less; but it would seem to be certain that they will be greater than the revenue already provided. Before the fiscal year closes we shall have to consider further loans or further taxes. How far are we prepared to meet this impending

obligation? How far are we in a position to provide for so vast a drain upon our financial and economic resources? The prospect is one not to be faced with a light heart. And yet I think it is one which can be faced with a stout heart. We have undertaken an enormous task, but fortunately we have enormous resources, and perhaps, even more to our good fortune, we have a mechanism better adapted to the task than the country ever before has had in similar exigencies.

#### CIVIL WAR EXPERIENCE

Let us contrast the present situation for a moment with the emergency which confronted the nation in its last hour of supreme peril. The drain upon our resources during the Civil War is comparable to that which we must now face. Small as the millions of those days seem as compared with our billions, they loomed up large in the imagination of the men of fifty years ago and caused doubts and tremors such as are in evidence at the present time. Contrast now the situation at the outset of the Civil War and the experience of that time, with our own present prospects.

Without entering into anything in the nature even of a sketch of the earlier conditions, let me remind you of two striking episodes in the financial history of the Civil War. One was the dislocation, indeed the breakdown, of the country's banking machinery on the very first occasion of its use. The initial loan of the Civil War, the \$150,000,000 of 6 per cent put out in 1861, was attempted to be marketed through advances from the banks of the North and through the eventual sale of these bonds on their part. It led within a few months to the suspension of specie payments by the banks; and the suspension of specie payments in those days meant suspension of all payments—virtual insolvency. Great as was the desire of the financial community, then as now, to come to the support of the government, the strain on the unorganized banks of those days was found to be too great at the very first trial. The banking machinery of the country proved quite unequal to lending adequate support to the government.

The second episode to which I will call your attention was the natural corollary from the first: the early resort to paper money and the early depreciation of the paper money. Inconvertible paper was issued at an early stage in the war, and to a greater

and greater extent as the war proceeded. How great was the disturbance of our monetary and industrial conditions because of the inflation of the war need not again be rehearsed. All students of the period know the evils which resulted for the community, and know too how vain was the effort of the government to meet its financial obligations by this means. Toward the close of the war it led to something like financial collapse, and the historian is tempted to speculate on the depths to which we might have fallen if it had been resorted to for a year or two longer.

On the other hand, taxation was resorted to slowly and hesitatingly and did not bring a really effective increase of revenue until the war was nearly over. It was not until the struggle had been going on nearly four years that, during the fiscal year 1864-1865, a great revenue was obtained by taxation. And the taxation of those days was almost exclusively indirect taxation, in the way of import duties and complicated excises, with unexpected and disturbing effects on the industries of the country at large.

#### PRESENT FACILITIES

Comparing now the unfortunate experiences of the past with the present situation and the present prospects, we find much that may lead us to take heart. We may not be prepared as adequately as we should be; but we are not entirely unprepared.

First of all, we have the federal reserve system. The government has at its disposal a great unified banking system which at once automatically utilizes the credit facilities of the country for the public service. Temporary loans can be arranged for over night. Certificates of indebtedness are taken and distributed with the minimum of strain. The flotation and distribution of the long-time securities are effectively aided by the same machinery. The financial community is no less patriotic than it was in 1861, but it is immensely better prepared to act as the Treasury's medium and to come to the Treasury's support. This advantage is nothing less than enormous. It removes the insidious temptation to resort to paper money, and saves the country the subsequent embarrassments and subsequent losses which such resort brought to us during the long period from the close of the Civil War to the resumption of specie payments in 1879, and which it will not fail to bring to the warring countries of the Continent which have been compelled to resort to the same demoralizing device.

I am not unaware that the utilization of our credit machinery by the government, and the extension of deposit credit which it will entail, may have the effect of inflation or something analogous to inflation. But inflation of this sort, in any case not easy to measure quantitatively and perhaps not susceptible of absolute proof, is at all events less dangerous for the future than the resort to fiat money. It is likely to correct itself automatically after the war. So long as specie payments are maintained, this sort of inflation cannot maintain itself permanently when conditions of peaceful commerce again have been restored. The unwelcome effects which it may have for the time being are in their nature transitory. If we maintain specie payments and refrain from resorting to paper money, we are spared such long continuing evils as came in the train of the Civil War issues.

But not only as regards our financial machinery and its utilization, but also as regards our tax system and its utilization are we in a state of preparedness. We have on hand, ready for immediate application, the machinery of the income tax. It is far from perfect; and yet it is immensely serviceable. If it had now to be set up *de novo*, we should have to wait at least a year, probably several years, before anything like the revenue now within our grasp could be obtained from it. It makes possible a resort at once to heavy levies without waiting for the slow process of getting the machinery of taxation in working order.

Moreover the machinery which is available for the administration of the income tax is serviceable also for that of the tax on excess profits. Separate returns are indeed to be called for in order to secure the collection of the latter, but the returns already made in previous years for the income tax will be available for purposes of comparison and correction, and the returns made for the income tax of the current year will be similarly of service. I would not minimize the perplexing problems which the Internal Revenue Bureau will have to solve in the administration of the excess profits tax. But it is no small alleviation that the income tax organization can be utilized without fundamental readjustment.

It is a good general maxim of taxation that *any* new levy should be initiated at a very moderate rate, and that the machinery of collection should be organized while the rate is still moderate. Of this perhaps no more striking illustration can be found than our

experience with the tax on distilled spirits. We are now levying that tax at the extraordinary rate of \$3.20 per gallon. The attempt to collect a very much smaller tax during the early years of the internal revenue system led to evasion and fraud on a great scale. Gradually the system of collection and supervision has been perfected; and in consequence, a rate of tax which twenty years ago, even ten years ago, would have been deemed quite beyond the possibilities of effective collection, is now imposed with confidence. I would not for a moment pretend that our method of levying the income tax has yet approached a stage of highly perfected adjustment—such a stage as has been reached in Great Britain, for example, only after three-quarters of a century of experience. But the framework is on hand; it has been set up under low rates and therefore under conditions of little strain; it is in working order. We are suddenly increasing the rates of the income tax in such way that the revenue will be at least triple that of the last fiscal year, and six times that of the revenue of any preceding fiscal year. We should not have been able to expand this financial resource had we not already been prepared through the previous establishment of a reasonably effective system.

#### THE REASONS WHY WE ARE PREPARED

It may not be amiss to indicate briefly how we happen to be in a situation so much more promising than ever before in a similar exigency. Partly it may be a matter of great good fortune; but partly it is a matter of deliberate facing of possibilities, a deliberate setting of our house in order, for which our political leaders and the country at large may take some credit. Both parties are entitled to credit for the establishment of the federal reserve system. The preparatory work was done under the administration of President Taft, through the medium of the Monetary Commission then established which evolved the preliminary scheme. The system in its final form was definitively worked out and put into operation under the leadership of the present administration. The income tax again, though not established until 1913, was a foregone conclusion from long continued previous discussion and from the ratification of the constitutional amendment. As regards the immediate resort to heavy taxation, both through the income taxes and the long list of others that figure in the war tax act, something

is due to the preaching of the economists, who, though not perhaps in entire agreement on the precise extent to which resort should be made to taxation, have nevertheless been unanimous in urging immediate substantial levies. Not a little, again, is due to the example of our ally, Great Britain, who has not hesitated to grapple frankly with the financial task, to face the fact that war entails immense financial sacrifices, and to call upon the British community to submit at once to drastic taxation. And finally, not least, much is due to the courageous spirit of our own administration, our Secretary of the Treasury, the leaders of both parties in the House and Senate. Inevitably there have been differences of opinion as to the degree to which taxation should be resorted to, and as to the precise form of loans and credit arrangements. But there has been no hesitation with regard to the need of utilizing at once all the available machinery for procuring huge resources at the earliest opportunity.

#### OUR INDUSTRIAL AND ECONOMIC SITUATION

What can be said now of the economic and industrial situation as contrasted with the strictly financial problems? In the early days of the European War much was said and many calculations were presented about the total resources of the several nations, their total wealth, their total annual income. We were told that Great Britain, France and Germany had so many billions of wealth, and therefore so much which was potentially available for the conduct of the war. It requires no profound analysis to make it clear that figures of this sort signify little. The total resources of a country cannot be poured into the melting pot. Immense parts of them are by their nature unavailable. The land, the houses and buildings, a large part of the factories and workshops, are committed to uses from which they cannot be diverted to war service. I may remark, parenthetically, it is fortunate that this is the case. If it were not, absolutely everything might be poured into the public treasury under the spur of patriotic zeal, and the very last item of wealth and property might be engulfed in the fearful waste of war. The possibilities of eventual recovery are the greater because it is impossible in the nature of things to spend and destroy everything for the purposes of war.

The real problem for war expenditure is this: how much is

there of *free* resources, how much can now be carved out and made available for military purposes and in what ways can it be made available? Our calculations and speculations should be directed not to the extent of the people's total wealth or total resources, but to the extent of their free and divertible resources and income. This is another way of saying that our attention should be directed to the potential savings, the potential economies, the things that we can do without. How much income in terms of money, and in terms of labor resources and commodity resources purchasable with money, can be not only spared, but made immediately available and put at the disposal of the government during the war?

Here the question at once arises, what are in ordinary times the free resources of the community? What are its ordinary savings? On this subject we are unfortunately but ill-informed and can make nothing more than a guess. The usual or normal fresh savings and fresh investments of the people of the United States are supposed to be somewhere between three to five billions. I make no pretense of certifying to the accuracy of even this rough figure. But whatever be the sum we thus start with, clearly it is no more than suffices for a start. Even if we put at the disposal of the Treasury every cent that we ordinarily put by and save, we do not begin to meet the needs of the present time. We must do much more.

But all experience teaches that under stress of war we can do more, very much more. During the Civil War the North raised by internal loans vastly more than it had ever put into productive enterprise in the years preceding the war. It raised in addition vastly greater sums by taxation than the country had ever before dreamed of raising. I will not say that there are no limits to the sums which can be raised by a combination of loans and taxes, but it is certain that the ordinary savings and the apparent free resources of normal times give no clue to what can be secured under stress of need and under the impulse of patriotic zeal. It may seem now that we have undertaken a formidable task in our first and second liberty loans. So it seemed during the Civil War with that first loan of \$150,000,000, which led, as I have already noted, to the breakdown of our banking machinery. The task seemed even more forbidding when in 1862 the United States resorted to the second great loan—what was then supposed to be the enormous issue of \$500,000,000 of 5-20 bonds. So it has been in the European

countries, where successive loans have met successive response. The initial loans have seemed staggering, and yet successive loans have met successive response and the limit has receded as the stress of need became greater.

What is thus true of the potentialities of loans is true also of the potential tax resources. We have begun at the very outset on a considerable scale, with tax levies heavier than those made by this country in any corresponding stage in previous exigencies, heavier too than those made by any other country at a corresponding stage in the present great conflict. It is not only within the bounds of possibility, it is more than probable, that we shall have to resort to still heavier levies and to levies more widely distributed. Yet here, as with regard to our borrowing capacity, we never know how much we can do until we know what we have to do. Our loans and our taxes already mean that we must begin to restrict and curtail, must learn to dispense with luxuries and comforts, perhaps with some things which we have regarded as necessities. We shall have to proceed further in the same direction. Every community must adjust its industries and its expenditures to the needs of a war through a gradual process. We have entered only on the first stage.

#### SOURCES YET UNUTILIZED

One last aspect of the case I would bring to your attention. How far are there resources which as yet we have not tapped? How far are there spare fractions of income not ordinarily reached either by any process of direct taxation or by any process of habitual saving and investment? In this country we have a great mass of prosperous workers who ordinarily spend the whole or almost the whole of their incomes, and who yet are in a position both to bear burdens of taxation and to make some savings from income. There are millions of skilled artisans, salaried men and women, well-to-do farmers, who go their way with ease in ordinary times, and whom the ordinary machinery of taxation and finance does not touch. It is not desirable to apply to this large stratum of the community any burdensome direct taxation of incomes. True, some direct levy on them is made through the present remodelling of our income tax; the limit of exemption, formerly \$3,000 to \$4,000 a year, has now been reduced to \$1,000 to \$2,000. But the rate of tax upon the lowest incomes now brought within the purview of the

tax is left very moderate, and this application of the income tax is rather a response to a question of principle than a probable means of attaining a substantial increase of revenue. Consumption taxes again, in the way of import duties and excises, doubtless can bring in something substantial; yet there has been a proper hesitation from resort to them at high rates.

On the other hand, the voluntary handing over of substantial parts of these incomes to the government through the broad distribution of public loans is feasible upon a much larger scale than has before been supposed. It offers in many respects great advantages. The small bond buyer is in the aggregate an important personage. And when he is reached by adequate facilities and proper propaganda, he will respond generously and quickly. At the same time the wide distribution of public loans is the most effective antidote to those consequences of public debts which have caused them to be most strongly opposed. A great public debt means the permanent maintenance of taxation for the purpose of meeting interest upon it, and so the permanent diversion of income from the great mass of the taxpayers to the smaller number of the holders of public securities. If however, the number of these holders be not small, but in the aggregate large; if the distribution of public loans be not solely among the rich and well-to-do, but widely dispersed through every class of the community, then some of the most undesirable features of the resort to loans, if not entirely obviated, will be much mitigated.

In this respect we may learn something from the enemy. The Germans have cultivated to a high degree the stimulation and collection of loan subscriptions from persons of moderate and small means. A rough summing up of the operations under their first five loans indicates that out of a total of something like forty-seven billions of marks (or eleven billions of dollars) about three-fifths have been in subscriptions of ten thousand marks or less. No doubt there are possibilities of manipulation in these figures. We must be on our guard against all official statements that come from that quarter. But there is no reason to question that subscriptions of moderate and small amounts have been heavy. It is gratifying that our own financial leaders are awake to the importance of reaching the small investors and are diffusing our loans as widely as possible. Of the total subscriptions to the first liberty loan, roughly three billions of dollars, one and one-fourth billions were

in amounts of less than ten thousand dollars and received in full their allotment out of the two billions of bonds finally issued, or the same proportion as that just noted for the German loans.

Our conclusion is that we may look forward to the future not indeed with a light heart, but with courage. We have assumed enormous responsibilities. We have not yet sufficiently provided for meeting even those of the present fiscal year. But we have taken great forward steps. We are ready to proceed further; and we may face coming events, not without anxiety, nor without a realization of what the contest means, but with a firm resolve to use our strength and our resources to the utmost, and with a firm confidence that the country will provide the means for the utmost military and naval strength.